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COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

KENNETH HAHN HALL OF ADMINISTRATION
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JOHN NAIMO
AUDITOR-CONTROLLER

March 13, 2015

TO: Supervisor Michael D. Antonovich, Mayor
Supervisor Hilda L. Solis
Supervisor Mark Ridley-Thomas
Supervisor Sheila Kuehl
Supervisor Don Knabe

FROM: John Naimo John Naimo
Auditor-Controller

SUBJECT: **L.A. CARE HEALTH PLAN FINANCIAL CONDITION REVIEW (Board Agenda Item 21-C, January 27, 2015)**

On January 27, 2015, your Board instructed the Auditor-Controller (A-C) to review the financial condition of L.A. Care Health Plan (L.A. Care or Agency), as required by the State of California (State) Welfare and Institutions Code Section 14087.9675. Your Board also instructed us to provide a plan for the County of Los Angeles' (County) involvement in monitoring L.A. Care.

L.A. Care is the Local Initiative Health Authority (Local Initiative) for the County, and is an independent, tax-exempt public agency created by the County, and initially funded by the State and the Federal Government of the United States of America (federal), to provide managed health care services to low-income County residents. The Agency was developed in response to the State's plan to transition Medi-Cal recipients to managed care. In 1994, Senate Bill (SB) 2092 was enacted, which enabled the creation of L.A. Care. Shortly after passage of SB 2092, your Board adopted an ordinance to establish L.A. Care as a separate legal entity from the County. The Agency is the nation's largest locally-based, publicly-operated health plan with approximately 1.67 million members, as of February 2015.

L.A. Care offers health care coverage through a variety of programs, which include Medi-Cal, L.A. Care Covered (Covered California), Cal Medi-Connect (Medi-Cal/Medicare dual eligibility), PASC-SEIU Homecare Workers Health Care, and Healthy Kids 0-5 plans. L.A. Care has a direct network of contracted providers, but primarily provides the delivery of health care services to members by contracting with its Plan

Partners, which are Anthem Blue Cross of California, Care 1st Health Plan, and Kaiser Foundation Health Plan. The purpose of these partnerships is to provide L.A. Care members more choices and flexibility with their health care needs.

Scope of Review

The purpose of our review was to evaluate the financial condition of L.A. Care. Our review included interviewing L.A. Care financial management, analyzing L.A. Care's budget and audited financial statements, evaluating internal policies and procedures related to their administrative and financial operations, and reviewing documentation related to their administrative expenses. We also compared L.A. Care's financial performance to the top three most comparable Local Initiatives in the State.

Results of Review

L.A. Care's operating revenues totaled approximately $4.14 billion in Fiscal Year (FY) 2013-14, and included funds from the California Department of Health Care Services, Centers for Medicare and Medicaid Services, State, County, individual member premiums, and various grant sources. L.A. Care's operating expenses totaled approximately $4.10 billion in FY 2013-14, and mainly consisted of health care expenses, such as capitation for professional services (i.e., payments to providers), inpatient/outpatient claims (e.g., hospital claims, emergency room claims, etc.), and pharmacy claims. In FY 2013-14, L.A. Care's operating revenues and expenses more than doubled from FY 2011-12 due to a large increase in Medi-Cal memberships. L.A. Care indicated that this was a byproduct of the Affordable Care Act, which expanded Medi-Cal to include low-income adults up to 138% of the federal poverty line.

L.A. Care's financial performance for FY 2013-14 was generally comparable to the financial performance of the top three Local Initiatives we reviewed (i.e., Inland Empire Health Plan serving Riverside and San Bernardino Counties, CalViva Health serving Fresno, Kings, and Madera Counties, and Health Plan of San Joaquin serving San Joaquin and Stanislaus Counties). We also noted that L.A. Care's administrative expenses have remained steady at approximately 4.5% of their total operating expenses for the last three fiscal years, which is favorable when compared to the 6.5% average administrative expenses of the other three Local Initiatives. L.A. Care management indicated that they periodically conduct informal cursory comparisons of L.A. Care's financial performance to other State health plans' financial performance.

Although L.A. Care's administrative expenses were reasonable when compared to the other three Local Initiatives, the Agency spent approximately $476,000 on meals and catering services for various work-related meetings, travel, workplace activities, and external training programs from October 2013 to January 2015. A portion of the expenses were for luncheons and dinners, including some three-course meals and entertainment. For example, in December 2014, the Agency paid $10,900 for 115 people (approximately $95 per person) to attend a retirement party for their former Chief Executive Officer (CEO). The retirement party included an open bar, entertainment, tray passed hors d'oeuvres, and hosted valet service. The Agency also spent an additional $12,400 on eight farewell luncheons for the former CEO from October to December 2014.

Details of our review are included in Attachments I and II.

Annual Reviews

We will continue to review L.A. Care's financial condition annually, and conduct other operational and financial audits as conditions merit. Annual reviews will include year-over-year ratio analysis of L.A. Care's audited financial statements, review of internal reports, audits by oversight agencies, management letters and other significant documentation, ongoing benchmarking against comparable Local Initiatives, and reviews of trends and emerging health industry issues with the potential for substantive impact on L.A. Care's financial condition.

Review of Report

We discussed our report with L.A. Care management, and they agreed with our findings and recommendations. L.A. Care's attached response (Attachment III) describes the corrective actions the Agency plans to take to address the recommendations in our report.

We thank L.A. Care management and staff for their cooperation and assistance during our review. If you have any questions please call me, or your staff may contact Robert Smythe at (213) 253-0100.

JN:AB:RS

Attachments

c: Sachi A. Hamai, Interim Chief Executive Officer
Patrick Ogawa, Acting Executive Officer, Board of Supervisors
Mitchell H. Katz, M.D., Director, Department of Health Services
L.A. Care Health Plan
John Wallace, Interim Chief Executive Officer
Tim Reilly, Chief Financial Officer
Public Information Office
Audit Committee

L.A. CARE HEALTH PLAN
FINANCIAL CONDITION REVIEW
FISCAL YEAR 2011-12 THROUGH 2013-14

Background

L.A. Care Health Plan (L.A. Care or Agency) is the Local Initiative Health Authority (Local Initiative) for the County of Los Angeles (County), and is an independent, tax-exempt public agency created by the County, and initially funded by the State of California (State) and the Federal Government of the United States of America (federal), to provide managed health care services to low-income County residents. The Agency was developed in response to the State's plan to transition Medi-Cal recipients to managed care. In 1994, Senate Bill (SB) 2092 was enacted, which enabled the creation of L.A. Care. Shortly after passage of SB 2092, your Board adopted an ordinance to establish L.A. Care as a separate legal entity from the County. The Agency is the nation's largest locally-based, publicly-operated health plan with approximately 1.67 million members, as of February 2015.

L.A. Care offers health care coverage through a variety of programs, which include Medi-Cal, L.A. Care Covered (Covered California), Cal Medi-Connect (Medi-Cal/Medicare dual eligibility), PASC-SEIU Homecare Workers Health Care, and Healthy Kids 0-5 plans. L.A. Care has a direct network of contracted providers, but primarily provides the delivery of health care services to members by contracting with its Plan Partners, which are Anthem Blue Cross of California, Care 1st Health Plan, and Kaiser Foundation Health Plan. The purpose of these partnerships is to provide L.A. Care members more choices and flexibility with their health care needs.

Financial Condition

L.A. Care's operating revenues totaled approximately $4.14 billion in Fiscal Year (FY) 2013-14, and included funds from the California Department of Health Care Services (DHCS), federal Centers for Medicare and Medicaid Services (CMS), State, County, individual member premiums, and various grant sources. L.A. Care's operating expenses totaled approximately $4.10 billion in FY 2013-14, and mainly consisted of health care expenses, such as capitation for professional services (i.e., payments to providers), inpatient/outpatient claims (e.g., hospital claims, emergency room claims, etc.), and pharmacy claims. In FY 2013-14, L.A. Care's operating revenues and expenses more than doubled from FY 2011-12 due to a large increase in Medi-Cal memberships. L.A. Care indicated that this was a byproduct of the Affordable Care Act, which expanded Medi-Cal to include low-income adults up to 138% of the federal poverty line.

Details of L.A. Care's operating revenues and expenses are provided in Table 1 of Attachment II.

Future Outlook of Revenues and Expenses

We reviewed L.A. Care's FY 2014-15 budget, and noted that membership is estimated to grow to 1.82 million members by fiscal year-end (September 2015), which is a 17% increase from their FY 2013-14 membership total of 1.55 million. As of February 2015, we confirmed membership has grown by 9% to 1.67 million for the year.

L.A. Care's FY 2014-15 budget also projects its operating revenues and expenses will increase to $6.63 billion (60%) and $6.56 billion (60%), respectively. L.A. Care indicated that the faster rate of growth in its revenues and expenses relative to its membership is mainly attributable to the projected 55% increase in the capitated revenues and expenses per member for the Agency's Medi-Cal and Cal Medi-Connect plans. The Agency's FY 2013-14 workforce of 1,294 is also projected to grow to 1,800 employees (39%) during FY 2014-15. L.A. Care indicated that they have established financial and performance objectives related to financial sustainability of their product lines, and plan to achieve these objectives by fiscal year-end.

L.A. Care is currently involved in various legal actions arising in the normal course of business, of which the outcomes are not determinable. However, L.A. Care has insurance policies covering such potential losses, and management indicated that any potential liability incurred will not have a material effect on L.A. Care's financial condition.

Financial Analyses

We used L.A. Care's financial information for FYs 2011-12 through 2013-14, and various financial ratios to determine the Agency's financial health and stability. We noted the following:

- **Short-term solvency, debt-paying capability, and ability to carry operating costs -** In FY 2013-14, L.A. Care's current assets exceeded their current liabilities by 18%, while liquid assets (i.e., cash, short-term securities, and accounts receivable) exceeded current liabilities by 15%. This indicates that the Agency has sufficient current resources to cover short-term liabilities, and is able to finance current operations and meet obligations as they fall due.

- **Ability to generate income in excess of expenses -** With the exception of FY 2011-12, the Agency has been generating sufficient income to meet expenses. L.A. Care indicated that the FY 2011-12 deficit was primarily due to the addition of Seniors and People with Disabilities (SPD) members into the Medi-Cal program. At the time, the capitation rate paid by DHCS for SPD members did not cover L.A. Care's costs, so the Agency's capitation revenue was unable to keep up with their health care expenses. However, in subsequent years, DHCS increased capitation rates for SPD members for certain counties Statewide, including the County, which aided in covering L.A. Care's costs.

- **Net equity requirements** - L.A. Care's relatively weak net position (excess of total assets over total liabilities) is a factor of regulatory compliance. For example, the Public Health Service Act (42 U.S.C. Sec. 300gg-18) and the California Health & Safety Code Section 1367.003 require large group health plans to spend at least 85% of health premium revenues on medical care, in effect restricting the annual fund net position of plans. We noted for the last three fiscal years, L.A. Care spends an average of 95% of revenues on medical care. In addition, Title 28 of the California Code of Regulations Section 1300.76 requires all health plans to maintain a minimum tangible net equity (TNE) to ensure a health plan's financial viability, and L.A. Care has complied with the minimum TNE requirement.

Details of L.A. Care's assets and liabilities are provided in Table 2 of Attachment II.

Comparison to Other Local Initiatives

The State organizes Medi-Cal managed care by county or groups of counties under six models, which include the Two-Plan, Geographic Managed Care, County Organized Health System, Regional, Imperial, and San Benito models. The County has adopted the Two-Plan model, which offers Medi-Cal members a choice of two health plans, one publicly run (Local Initiative) and the other privately run (commercial insurance), creating competition between the two plans and ultimately leading to better care for members.

The State currently has ten Local Initiatives serving 14 counties, with L.A. Care being the largest Local Initiative. We reviewed L.A. Care's financial performance with the top three most comparable Local Initiatives in terms of memberships for FY 2013-14, which are the Inland Empire Health Plan serving Riverside and San Bernardino Counties with approximately 909,200 members, CalViva Health serving Fresno, Kings, and Madera Counties with approximately 283,600 members, and Health Plan of San Joaquin serving San Joaquin and Stanislaus Counties with approximately 271,900 members.

For FY 2013-14, L.A. Care's financial performance was generally comparable to the financial performance of the three Local Initiatives. However, we noted that administrative expenses of the other three Local Initiatives were slightly higher, averaging 6.5% of their total operating expenses in FY 2013-14. L.A. Care's administrative expenses have remained steady at approximately 4.5% for the last three fiscal years. L.A. Care management indicated that they periodically conduct informal cursory comparisons of L.A. Care's financial performance to other State health plans' financial performance.

Details of our comparison are provided in Table 3 of Attachment II.

Administrative Expenses

Although L.A. Care has experienced significant growth in the last three fiscal years, the Agency has consistently kept their administrative expenses at approximately 4.5% of their total operating expenses. With the increase in growth, L.A. Care's administrative expenses doubled from $89.41 million in FY 2011-12 to $176.83 million in FY 2013-14, with salaries and employee benefits increasing by 77%. L.A. Care indicated that this was due to the Agency's workforce expanding from 703 employees in FY 2011-12 to 1,294 employees (84%) in FY 2013-14.

We reviewed the reasonableness of L.A. Care's discretionary administrative expenses and noted that from October 2013 to January 2015, the Agency spent approximately $476,000 on meals and catering services for work-related meetings, travel, workplace activities, and external training programs. A portion of the expenses were for luncheons and dinners, including some three-course meals and entertainment. For example, in December 2014, the Agency paid $10,900 for 115 people (approximately $95 per person) to attend a retirement party for their former Chief Executive Officer (CEO). The retirement party included an open bar, entertainment, tray passed hors d'oeuvres, and hosted valet service. The Agency also spent an additional $12,400 on eight farewell luncheons for the former CEO from October to December 2014.

L.A. Care's internal policies state that business entertainment and meals are appropriate and represent a valid charge to the Agency, but that events must be infrequent and approved by L.A. Care management. The policy also states that alcoholic beverages are allowable if they are provided in conjunction with business entertainment, and approved by the CEO. We verified that the former CEO's retirement party and farewell luncheons were approved by executive managers at L.A. Care.

L.A. Care is a public agency that primarily serves the County's most vulnerable and low-income residents. Due to their high visibility within the community, the Agency's management should consider establishing more detailed guidelines and dollar limits for discretionary spending on business entertainment and meals. Agency management should also reevaluate their policy that allows Agency funds to be spent on alcoholic beverages served at various events. In addition, L.A. Care should consider providing its Board of Governors with periodic reports of discretionary spending relating to business entertainment and meals, including amounts and reasons for the events.

Internal Controls and Oversight

We verified that L.A. Care maintains policies and procedures that define key components of its administrative operations, including addressing generally accepted principles of internal financial controls. The Agency also has monitoring plans in place for all their business units, including compliance with financial and administrative requirements. Proper internal controls are intended to ensure an appropriate level of safeguards over the Agency's resources, as well as the accuracy, efficiency, and effectiveness of its administrative processes. L.A. Care management is responsible for oversight and compliance with its internal control framework.

Oversight by Governing Agencies

L.A. Care's operations are reviewed by various governing agencies, including the State Department of Managed Health Care (DMHC), CMS, and DHCS. DMHC conducts financial examinations at least once every five years and additional examinations, as needed, to verify the Agency's fiscal and administrative compliance with regulatory requirements. CMS conducts program audits at least once every three years for each of the Agency's plans to evaluate whether the plans have implemented an effective compliance program, including instituting effective measures to prevent, detect, and correct fraud, waste, and abuse. DHCS conducts annual medical performance audits to verify that the medical services/programs offered by the Agency comply with federal and State laws and requirements. We reviewed the governing agencies' most recent issued reports, and there were no issues of concern to the County arising from these reviews.

We will continue to review and report on L.A. Care's financial condition annually. Our annual reviews will include year-over-year ratio analysis of L.A. Care's audited financial statements, review of internal reports, audits by oversight agencies, management letters and other significant documentation, ongoing benchmarking against comparable Local Initiatives, and reviews of trends and emerging health industry issues with the potential for substantive impact on L.A. Care's financial condition.

TABLE 1
OPERATING REVENUES AND EXPENSES
FISCAL YEARS (FY) 2011-12 THROUGH 2013-14

(In Thousands)	FY 2011-12	FY 2012-13	FY 2013-14
Operating Revenues			
Capitation	$ 1,933,594	$ 2,687,358	$ 4,137,151
Grant income	6,486	5,019	3,182
Total Operating Revenues	**$ 1,940,080**	**$ 2,692,377**	**$ 4,140,333**
Operating Expenses			
Capitation-professional services	$ 1,357,947	$ 1,833,993	$ 2,531,919
Inpatient/outpatient claims	319,029	481,635	933,551
Pharmacy claims	125,082	165,802	283,888
Administrative expenses	89,414	115,767	176,825
Provider incentive and risk provisions	28,583	20,215	109,824
Medical administrative expenses	30,453	33,768	58,521
Total Operating Expenses	**$ 1,950,508**	**$ 2,651,180**	**$ 4,094,528**
Income (Loss) from Operations	**$ (10,428)**	**$ 41,197**	**$ 45,805**

TABLE 2
ASSETS, LIABILITIES, AND NET POSITION
FISCAL YEARS (FY) 2011-12 THROUGH 2013-14

(In Thousands)	FY 2011-12	FY 2012-13	FY 2013-14
Current Assets:			
Cash and cash equivalents	$ 322,215	$ 689,752	$ 595,351
Investments - fair value	113,492	159,627	300,208
Capitation receivable	54,619	287,138	393,087
Other current assets	8,948	73,121	27,298
Total Current Assets	**$ 499,274**	**$ 1,209,638**	**$ 1,315,944**
Non-Current/Capital Assets	**$ 10,071**	**$ 24,238**	**$ 38,805**
Total Assets	**$ 509,345**	**$ 1,233,876**	**$ 1,354,749**
Current Liabilities:			
Accounts payable and accrued liabilities	$ 19,883	$ 39,024	$ 41,509
Subcapitation payable	209,645	836,634	629,201
Grants payable	2,079	1,195	827
Reserves for claims	93,986	125,800	302,457
Other accrued medical expenses	7,168	9,389	93,062
Reserves for provider incentives	35,898	33,169	50,258
Total Current Liabilities	**$ 368,659**	**$ 1,045,211**	**$ 1,117,314**
Deferred Rent/Revenues	**$ 1,428**	**$ 12,722**	**$ 17,361**
Total Liabilities	**$ 370,087**	**$ 1,057,933**	**$ 1,134,675**
Net Position:			
Net investment in capital assets	$ 9,693	$ 13,038	$ 28,654
Restricted	363	302	300
Unrestricted	129,202	162,603	191,120
Total Net Position	**$ 139,258**	**$ 175,943**	**$ 220,074**
Total Liabilites & Net Position	**$ 509,345**	**$ 1,233,876**	**$ 1,354,749**

TABLE 3
LOCAL INITIATIVES - FINANCIAL COMPARISON
FISCAL YEAR 2013-14

Performance Factors:	L.A. Care Health Plan	Inland Empire Health Plan	CalViva Health	Health Plan of San Joaquin
Market liquidity	FAIR	FAIR	FAIR	FAIR
Short-term liquidity	FAIR	FAIR	FAIR	FAIR
Ability to carry operating costs	GOOD	GOOD	WEAK	GOOD
Ability to generate income in excess of expenses	GOOD	GOOD	GOOD	GOOD
Profitability	FAIR	FAIR	FAIR	WEAK
Overall Performance Rating	**FAIR**	**FAIR**	**FAIR**	**FAIR**
Governing Agencies Net Equity Requirement	**MET**	**MET**	**MET**	**MET**
Administrative Expenses / Operating Expenses	**4.3%**	**6.6%**	**6.2%**	**6.7%**

L.A. Care
HEALTH PLAN

February 27, 2015

John Naimo
Auditor-Controller
County of Los Angeles
500 West Temple Street, Room 525
Los Angeles, California 90012

Dear Mr. Naimo:

Thank you for the opportunity to review your office's report entitled L.A. Care Health Plan Financial Condition Review. We would also like to thank the Auditor-Controller for its positive and highly professional working relationship with L.A. Care throughout the review period.

L.A. Care is in agreement with the report and will work to implement the recommendations. L.A. Care's Board and management are committed to implementing best practices for public agencies and expenditures.

Additionally, we would like to elaborate on administrative and discretionary expenditures made by L.A. Care during the period of your review. As you noted in your report, L.A. Care was established by the County authorized by State legislation (SB 2092). Among its provisions, SB 2092 requires L.A. Care, as the Local Initiative under Medi-Cal Managed Care, to convene a Technical Advisory Committee, a Children's Health Consultant Advisory Committee, and Regional and Executive Community Advisory Committees. There are 11 Regional Community Advisory Committees meeting throughout Los Angeles County. These committees, comprised of volunteer health experts in the community and members of L.A. Care, provide input into operations of the health plan. As of February 26, 2015, there are approximately 260 people participating in these committees, and L.A. Care provides refreshments at the meetings.

We would also like to note that because L.A. Care was established to engage in the competitive health care sector, in order to support staff productivity and retention, we hold employee events and wellness activities that maintain the morale of our workforce.

Lastly, as indicated above, California's implementation of the Affordable Care Act has led L.A. Care to experience significant growth over the last year including new populations and newly added benefits to the Medi-Cal program. This includes the Medi-Cal Expansion population, new behavioral health and autism benefits, the Cal MediConnect program for beneficiaries dually eligible for Medicare and Medi-Cal, the addition of Long Term Services and Supports to Medi-Cal Managed Care, and participation in Covered California, the State's health benefit exchange. This growth has required many policy and implementation meetings statewide, as well as extensive outreach with providers and stakeholders to train and engage them on program changes.

ML0000 00/00

For your consideration we have provided the attached chart which details the meals and catering expenditures noted in your report.

Again, thank you for the opportunity to review the report and we look forward to working with your office as we implement the recommendations.

Sincerely,

John Wallace
Interim Chief Executive Officer

CC: L.A. Care Board of Governors

Meals and Catering		
Description	**Purpose/Use**	**Total**
Board of Governors Services	Monthly meetings for L.A. Care's Board of Governors and its subcommittees including annual offsite strategic planning retreat; all are open to the public.	17,019
Community Advisory Committees	Regional Community Advisory Committee (RCAC) monthly meetings in 11 Regions; Executive Community Advisory Committee (elected representatives from RCACs) monthly meetings. RCAC community health outreach activities.	65,744
Internal Organization and Workplace Activities	Employee meetings, retention and team building activities including employee events, employee wellness (fresh fruit Fridays). Includes CEO farewell lunches.	175,787
Marketing Outreach Activities	Marketing and training for physicians and community activities. Includes CEO retirement party attended by external health leaders and L.A. Care senior management.	58,090
External Training Programs	Continued Medical Education (CME) for physicians, and L.A. Care participation in local community activities such as provider awards events. Three-course dinner in question was for physicians outreach for Electronic Records Meaningful Use (L.A. Care has played a leading role in supporting Health Information Technology capability among safety net providers).	65,445
Business Travel and Sales	Meals for authorized work related travel and sales-related meals	$ 93,660
Total		**$ 475,745**

COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

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JOHN NAIMO
AUDITOR-CONTROLLER

April 29, 2015

TO: Supervisor Michael D. Antonovich, Mayor
Supervisor Hilda L. Solis
Supervisor Mark Ridley-Thomas
Supervisor Sheila Kuehl
Supervisor Don Knabe

FROM: John Naimo
Auditor-Controller

SUBJECT: **STATUS REPORT – EXTENSION REQUEST FOR THE L.A. CARE HEALTH PLAN FINANCIAL CONDITION FOLLOW-UP REVIEW (Board Agenda Item 37, March 17, 2015)**

On March 17, 2015, your Board instructed the Auditor-Controller to conduct a follow-up review, and report back in 45 days on how L.A. Care Health Plan (L.A. Care) is implementing the recommendations from our March 13, 2015 audit report of L.A. Care's financial condition.

We are working with L.A. Care management to obtain documentation supporting the implementation status of our recommendations. Some of this documentation is expected to be presented and discussed during L.A. Care's May Board Meeting. We anticipate issuing our report to your Board by May 29, 2015.

If you have any questions, please contact me, or your staff may contact Robert Smythe at (213) 253-0100.

JN:AB:RS

c: Sachi A. Hamai, Interim Chief Executive Officer
Patrick Ogawa, Acting Executive Officer, Board of Supervisors
Mitchell H. Katz, M.D., Director, Department of Health Services
<u>L.A. Care Health Plan</u>
John Baackes, Chief Executive Officer
Tim Reilly, Chief Financial Officer
Public Information Office
Audit Committee

COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

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JOHN NAIMO
AUDITOR-CONTROLLER

December 30, 2015

TO: Supervisor Hilda L. Solis, Chair
Supervisor Mark Ridley-Thomas
Supervisor Sheila Kuehl
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: John Naimo Arlene Barrera for
Auditor-Controller

SUBJECT: **L.A. CARE HEALTH PLAN ADMINISTRATIVE COST ANALYSIS REVIEW**

We have completed a review of L.A. Care Health Plan's (L.A. Care or Agency) administrative cost analysis. L.A. Care is the licensed Local Initiative Health Authority (Local Initiative) for the County of Los Angeles (County), and is an independent, tax-exempt public agency created by the County to provide managed health care services to low-income County residents. Title 28 of the California Code of Regulations Section 1300.78(b) requires that administrative costs of licensed health care service plans should not exceed 15% of each plan's total revenues.

Background

During our review of L.A. Care's financial condition issued in March 2015, we noted that the Agency's administrative expense ratio was approximately 4.5% for Fiscal Years (FY) 2011-12 through 2013-14, which was lower than the average 6.5% administrative expense ratio of the three most comparable Local Initiatives (i.e., CalViva Health Plan, Inland Empire Health Plan, and Health Plan of San Joaquin) we used to compare to the Agency. We also noted that L.A. Care primarily provides the delivery of health care services to members by contracting with its Plan Partners (i.e., Anthem Blue Cross of California, Care 1st Health Plan, and Kaiser Foundation Health Plan). The purpose of these partnerships is to provide L.A. Care members more choices and flexibility with their health care needs.

In June 2015, we conducted a follow-up review, and reported to your Board regarding L.A. Care's implementation status of the recommendations from our March 2015 report on the Agency's financial condition. In addition, we noted that L.A. Care's Plan Partners have additional administrative expenses that are not factored into L.A. Care's total administrative costs. As a result, certain adjustments may be necessary to ensure that an accurate comparison of administrative costs can be made between L.A. Care and the other Local Initiatives.

To address the concerns from our June 2015 review of the Agency's total administrative expenses, L.A. Care made relevant adjustments, and prepared an analysis of their FY 2013-14 administrative costs compared to eight Local Initiatives (i.e., Inland Empire Health Plan, CalViva Health Plan, Health Plan of San Joaquin, Alameda Alliance for Health, Kern Health Systems, San Francisco Community Health Authority, Santa Clara County Health Authority, and Contra Costa County Medical Services) and three County Organized Health Systems (i.e., Orange County Health Authority, San Mateo Health Commission, and Partnership Health Plan).

Scope and Results of Review

For this review, we examined the September 2015 administrative cost analysis that L.A. Care prepared covering FY 2013-14 (Attachment). Our review included interviewing L.A. Care financial management and staff, and evaluating the accuracy and reasonableness of the Agency's administrative cost analysis report. We determined that the methodology L.A. Care used for adjusting their total revenues and administrative expenses to exclude their Plan Partners line of business in their analysis is reasonable, and that the Agency's unadjusted and adjusted administrative expense ratios did not exceed the California Code of Regulations' maximum administrative expense to total revenues ratio of 15%, as discussed in detail below. In addition, we compared the revenue and administrative expense information L.A. Care included in their analysis to the figures the health plans reported to the California Department of Managed Health Care, and verified that the information reconciles, and is complete and accurate.

Comparison to Other Health Plans

L.A. Care's Administrative Cost Analysis

L.A. Care's analysis indicates that although the Agency is the largest health plan compared to the other 11 health plans the Agency used to compare their business, L.A. Care has one of the lowest administrative expense ratios at 4.3% for FY 2013-14 (Figure 2.0), with roughly 64.6% of the Agency's health care expenses paid by capitation (i.e., fixed per-enrollee payments to Plan Partners), and the remaining 35.4% paid by non-capitation (i.e., payments to direct in-network providers) (Figure 3.0). Figure 3.0 of the Agency's analysis also shows that nine health plans generally delegate (i.e., contract out managed health care services) a percentage of their business to contracted parties, with CalViva Health Plan delegating nearly all of its business. L.A. Care indicated that there is variability (e.g., size of health plans, percentage of delegated business, etc.) across the health plans that would affect their administrative expenses if the expenses are adjusted to account for the delegation.

In addition, L.A. Care recalculated their administrative expense ratio to exclude the Agency's Plan Partners line of business from their overall operations (Figure 4.0). L.A. Care's total revenues would be reduced by $1.7 billion, from $4.1 billion to $2.4 billion, and their administrative expenses reduced by $29.0 million, from $176.8 million to $147.8 million. As a result, the Agency's administrative expense ratio would increase from 4.3% to 6.2%. L.A. Care's analysis further illustrates that with these adjustments, the Agency's administrative expense ratio would be approximately the average of all of the other health plans' unadjusted ratios of 6.1% (Figure 5.0).

Additional Administrative Cost Analyses

Since L.A. Care only adjusted their figures to exclude their delegated line of business and not the other health plans' figures, we contacted the three Local Initiatives we compared L.A. Care to in our March 2015 review to provide us their adjusted total revenues and administrative expenses to exclude their delegated lines of business. Although Inland Empire Health Plan and Health Plan of San Joaquin were unable to provide us their adjusted revenues and administrative expenses, we noted that CalViva Health Plan's ratio would remain the same at 5.9%, since they delegate nearly all of their business. L.A. Care's adjusted administrative ratio of 6.2% would only be slightly higher than CalViva's ratio.

We also worked with the Agency to determine what L.A. Care's administrative costs would be if the Agency did not contract at all with its Plan Partners (i.e., did not delegate direct care and administrative expenses). L.A. Care recalculated their revenues and administrative expenses, and estimated that their total revenues would remain the same, but their administrative expenses would increase by $23.5 million to $200.3 million. The increase would primarily consist of non-medical salaries and employee benefits to support the additional members. This would slightly increase their administrative expense ratio to 4.8%. We noted that even with these adjustments, the Agency's administrative expense ratio would be lower than the average of all of the other health plans' unadjusted ratios.

As previously mentioned, L.A. Care's FY 2013-14 administrative expenses attributed to Plan Partners was $29.0 million, and included employee salaries and benefits, temporary labor and recruitment, services and supplies, marketing efforts, etc. We reviewed the high-level details of these administrative expenses provided by L.A. Care, and determined that the expenses are generally allowed under Title 28 of the California Code of Regulations Section 1300.78(a).

Current Administrative Expenses

From FY 2013-14 through September 30, 2015, L.A. Care's total revenues and administrative expenses increased from $4.1 billion to $6.4 billion (54%) and $176.8 million to $261.6 million (48%), respectively. L.A. Care's slightly higher growth in total revenues relative to administrative expenses has decreased the Agency's administrative expense ratio to 4.1%. L.A. Care indicated that the increase in total revenues was due to the increase in their Medi-Cal Expansion membership caused by the Affordable Care Act roll out, while their administrative expenses to support the new members grew at a slightly lower rate.

Review of Report

We discussed our report with L.A. Care management, and they agreed with our assessment of their analysis and the additional administrative cost analyses we conducted. We will continue to review L.A. Care's financial condition annually, and will conduct our next review in spring 2016. We will also conduct other operational and financial audits in the future, as needed. We thank L.A. Care management and staff for their cooperation and assistance during our review. If you have any questions, please contact me, or your staff may contact Robert Smythe at (213) 253-0100.

JN:AB:PH:RS:JU

Attachment

c: Sachi A. Hamai, Chief Executive Officer
Patrick Ogawa, Acting Executive Officer, Board of Supervisors
Mitchell H. Katz, M.D., Director, Los Angeles County Health Agency
John Baackes, Chief Executive Officer, L.A. Care Health Plan
Tim Reilly, Chief Financial Officer, L.A. Care Health Plan
Public Information Office
Audit Committee

L.A. Care
HEALTH PLAN

September 30, 2015

John Naimo
Auditor-Controller
County of Los Angeles
500 West Temple St. Room 525
Los Angeles, California 90012

Tim Reilly
Chief Financial Officer

Dear Mr. Naimo,

This is a follow-up to our conversation on May 13, 2015. At that time, we met to discuss your financial review of L.A. Care Health Plan and to plan for future reviews. During our discussion it was agreed that L.A. Care would get back to you with an analysis of administrative costs, and how to appropriately compare L.A. Care's costs with similar health plans. We have completed our analysis and it is presented below.

As you know, in early 2015, the Board of Supervisors instructed your office to review the financial condition of L.A. Care. Your review included interviewing L.A. Care financial management, analyzing L.A. Care's audited financial statements and budget, evaluating internal policies and procedures related to their administrative and financial operations, and reviewing documentation related to their administrative expenses. You also compared L.A. Care's financial performance to comparable Local Initiative Health Authorities in the California.

You noted in your March 13, 2015 review that for fiscal year 2013-14, L.A. Care's financial performance was generally comparable to the financial performance of three Local Initiatives, Inland Empire Health Plan, CalViva Health and Health Plan of San Joaquin. You also noted that the administrative expenses of these three Local Initiatives were slightly higher, averaging 6.5% of their total operating expenses in fiscal year 2013-14, as seen in your "Table 3" in Figure 1.0 below.

Figure 1.0

TABLE 3
LOCAL INITIATIVES - FINANCIAL COMPARISON
FISCAL YEAR 2013-14

Performance Factors:	L.A. Care Health Plan	Inland Empire Health Plan	CalViva Health	Health Plan of San Joaquin
Market liquidity	FAIR	FAIR	FAIR	FAIR
Short-term liquidity	FAIR	FAIR	FAIR	FAIR
Ability to carry operating costs	GOOD	GOOD	WEAK	GOOD
Ability to generate income in excess of expenses	GOOD	GOOD	GOOD	GOOD
Profitability	FAIR	FAIR	FAIR	WEAK
Overall Performance Rating	FAIR	FAIR	FAIR	FAIR
Governing Agencies Net Equity Requirement	MET	MET	MET	MET
Administrative Expenses / Operating Expenses	4.8%	6.6%	6.2%	6.7%

In the June 3, 2015 update to L.A. Care's Board of Supervisors, your office reported that while L.A. Care's administrative expenses were lower than the average administrative expenses of the three most comparable Local Initiatives, there may be other issues that need to be accounted for in the comparison. You noted that "L.A. Care's Plan Partners have additional administrative costs that do not factor into L.A. Care's total administrative costs." Your office concluded that "As a result, certain adjustments may be necessary to ensure that an accurate comparison of administrative costs can be made between L.A. Care and other Local Initiatives." You asked L.A. Care to prepare an analysis that would allow for a more accurate comparison with other public plans.

Presented below is an analysis of the public health plan's administrative costs. The Local Initiatives and County Organized Health Systems (COHS) across California vary greatly in terms of membership, revenue, expense, income and operating configurations. To provide a complete picture to account for these variations I am providing three different views of administration expense. First, I have a straight forward comparison of L.A. Care to all of other public plans. Second, I'm providing an analysis of the configuration of the health plan's network to illustrate how much of the administrative work is delegated to a third party. Lastly, I have computed L.A. Care's administrative costs without the Plan Partner's (Medi-Cal) business.

1) Straight forward Public Health Plan Comparison

Figure 2.0 below, compares L.A. Care to 11 other public plans, both Local Initiatives and COHS, operating in California. The plans range in annual revenue from $4.1 billion (L.A. Care) down to $54 million (Ventura County). L.A. Care is the largest in terms of membership, annual revenue and total administrative expense but has one of the lowest administrative ratios as well administrative costs per member per month (PMPM).

Figure 2.0

Health Plan Comparison
Fiscal Year Ending 2014

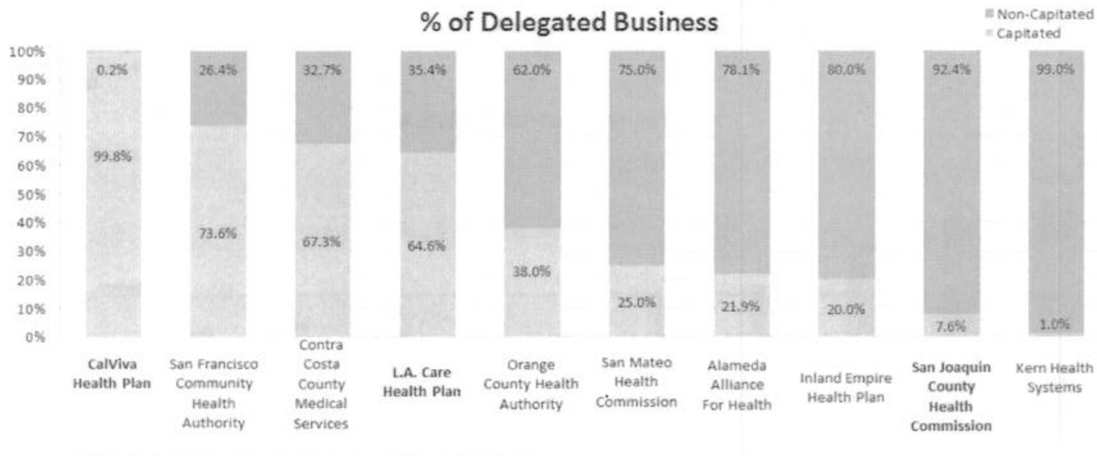
($ 1,000's unless indicated)	Alameda Alliance For Health	Contra Costa County Medical Services	CalViva Health Plan	Inland Empire Health Plan	L.A. Care Health Plan	Orange County Health Authority	San Francisco Community Health Authority	San Joaquin County Health Commission	Santa Clara County Health Authority	San Mateo Health Commission	Kern Health Systems	Partnership Health Plan
Member Months	2.2M	1.5M	2.7M	8.3M	16.8M	6.3M	1.1M	2.4M	2.0M	1.4M	1.9M	4.3M
Total Revenues	$628,340	$427,884	$573,160	$1,849,082	$4,140,333	$2,009,533	$324,899	$470,389	$422,020	$732,258	$428,808	$1,615,050
Admin Expense	$46,557	$15,429	$33,728	$87,950	$176,825	$80,155	$33,158	$23,781	$21,585	$66,779	$27,868	$64,340
Admin (%)	7.4%	3.6%	5.9%	4.8%	4.3%	4.0%	10.2%	5.1%	5.1%	9.1%	6.5%	4.0%
Admin PMPM	$21.03	$10.41	$12.49	$10.61	$10.54	$12.69	$30.17	$9.78	$10.81	$48.01	$14.52	$14.81

**Data source from DMHC financial reporting portal (http://wpso.dmhc.ca.gov/fe/search)*
***Plans' fiscal year-ends differ, all data used represents annual filings for CY or FY ending 2014*

2) Administrative Expenses in the Context of Provider Network Configuration (e.g. Delegation)

To assess how comparable public plan administrative costs are, presented below in Figure 3.0 is a comparison of the percentage of health care expenses that are paid by capitation along with the corresponding measure of delegated direct care and administrative expense. The top portion of the columns signifies the non-capitated share of business while the bottom half represents the capitated. As you can see below, there is a lot of variability across the health plans which would affect their administrative costs if adjusted to account for the delegation.

Figure 3.0



**Information gathered from a survey of represented plans and DMHC filings*
***Plans' fiscal year-ends differ, all data used represents annual filings for CY or FY ending 2014*

3) L.A. Care's Administrative Expenses with Plan Partner's Business Removed

L.A. Care insured 1.4 million Medi-Cal members during the fiscal year that ended September 30, 2014, which translates to 16.8 million member months. Of these members, 789,000 members, or 9.4 million member months, elected to receive their health care from one of our three Plan Partners (Anthem, Care 1st or Kaiser). L.A. Care pays these partners a capitated rate per member per month and incurs various administrative expenses, both of which are reported on our financial statements under health care expenses and administrative expenses, respectively. L.A. Care's recorded administrative expense associated with Plan Partner membership is low. To accurately compare L.A. Care's overall administrative costs to other plans, we have separated the Plan Partners line of business (LOB) from the rest of our operations, as seen in figure 4.0.

Figure 4.0

Health Plan Comparison with L.A. Care Adjustment
Fiscal Year Ending 2014

($ thousands unless indicated)	Contra Costa County Medical Services	Orange County Health Authority	L.A. Care Health Plan	Inland Empire Health Plan	San Joaquin County Health Commission	CalViva Health Plan	L.A. Care Excl. Plan Partners	Kern Health Systems	Alameda Alliance For Health	San Mateo Health Commission	San Francisco Community Health Authority
Member Months	1.5M	6.3M	16.8M	8.3M	2.4M	2.7M	7.3M	1.9M	2.2M	1.4M	1.1M
Total Revenues	$427,884	$2,009,533	$4,140,333	$1,849,082	$470,389	$573,160	$2,401,017	$428,808	$628,340	$732,258	$324,899
Admin Expense	$15,429	$80,155	$176,825	$87,950	$23,781	$33,728	$147,801	$27,868	$46,557	$66,779	$33,158
Admin (%)	3.6%	4.0%	4.3%	4.8%	5.1%	5.9%	6.2%	6.5%	7.4%	9.1%	10.2%
Admin PMPM	$10.41	$12.69	$10.54	$10.61	$9.78	$12.49	$20.24	$14.52	$21.03	$48.01	$30.17

**Data source from DMHC financial reporting portal (http://wpso.dmhc.ca.gov/fe/search)*
***Plans' fiscal year-ends differ, all data used represents annual filings for CY or FY ending 2014*

Excluding the Plan Partners Medi-Cal LOB in our comparison, L.A. Care drops to the second largest plan in terms of membership, but remains the largest in revenue in California. It is important to note that this is comparing L.A. Care with an adjustment to account for delegation to all other plans unadjusted. If you refer to figure 3.0 above, there are multiple plans with a reasonable amount of delegated business. If those plans were also adjusted to exclude their delegation, other plans